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Serial Nos. 1

Previous References.

Later References.

GENERAL AND REVENUE SECRETARIAT

Serial Nos. One

Part B for March 50

SUBJECT

White Paper on the Budget of the Government of India for 1950-51

Sd 2/6/50

Submitted to His Highness.

I submit herewith, for the gracious perusal of His Highness, a copy of the White Paper on the Budget of the Government of India for 1950-51, giving a brief account of the economic developments against the background of which the budget for 1950-51 has been prepared.

K. Chengalaraya Reddy.
CHIEF MINISTER.

Bangalore,
28th February 1950.

C. 1295/49-50.

Record of Cases submitted for the Orders of His Highness the Maharaja.

Subject.

White Paper on the Budget of the Government of India for 1950-51.

1028

Order.

VKN.
2/3/50.

Chief Secy)
VKN.
6/3/50.

6/3/50

C.B.

There is apparently some misapprehension. We wanted P.S. to H.H. & retain only the C. proceedings & abstract of C. decisions, but not any of every paper sent with a S.N. Please telephone & also write.

Telephoned to the Pri Secy to H.H. He says that the copy was retained as desired by H.H. & is accountable from the Pri Secy to Ch. Hist that only three copies were received, that one was retained by the Ch. Hist, the other given to the Finance Secy and the 3rd copy returned in the Palace. There will therefore be one copy in the file. The Govt of India will be requested to send one more copy if approved.

Chief Secy) 6/3/50

Writ
7.3.50
7.3.50

Subtd with a draft letter to the Ministry of Finance Govt. of India, for appl. or other orders.

7/3/50.

Letter No. 11127/C.B., dated 9.3.50, issued.

8-3-50

Rec'd. 2 copies of the White Paper.
If appl. this will be closed in 'B' Section.
Subtd.

17/3/50

17.3.50.

XXXXXXXXXXXXXXXXXXXXXXXXX

11887/50

9th March, 50

XXXXXXXXX
XXXXXXXXXXXX

The Secretary to the Government of India,
Ministry of States, New Delhi.

I am directed to request that two more copies of the White Paper on the Budget of the Government of India for 1950-51, may kindly be sent for reference by this Government.

Yours faithfully,

9.3.50.

for Chief Secretary to Government.

9/3

9/3/50

11887/CD

To

The Secy. to the
Govt. of India
Ministry of ~~Finance~~ States
New Delhi.

Sir,

I am directed to request ~~that~~ ~~Yours Kindly to forward~~ that two more copies of the White Paper on the Budget of the Govt. of India for 1950-51, may kindly be sent for reference by this Govt.

Yours faithfully,

Sd/- [illegible]
Sec. to Govt.

Issued
9/3/50

Copy forwarded ~~for~~ to the Secy. to the Govt. of India, Ministry of States, New Delhi, for info.

Subtd.
7/3/50.

8.3.50.

GOVERNMENT OF INDIA

सत्यमेव जयते

WHITE PAPER

ON

BUDGET, 1950-51

PRINTED IN INDIA BY THE MANAGER
GOVT. OF INDIA PRESS, NEW DELHI 1950

WHITE PAPER

ON THE

BUDGET, 1950-51.

This Paper gives a brief account of the economic developments against the background of which the budget for 1950-51 has been prepared and explains the salient features of the Revised Estimates for 1949-50 and the Budget Estimates for 1950-51.

Review of Economic Conditions

2. The main problem in this country in the post-war years has been that of keeping inflationary trends under control. As a result of the war, while the purchasing power in the hands of the community increased considerably, the available supply of commodities in the post-war period has not been sufficient to meet the growing demands for them. The position has been further aggravated by the shortage of foodstuffs, clothing and other essential commodities. It was also made more difficult by the influx of population from Pakistan, as a result of disturbances following the partition, and the dislocation of the economic life of the Provinces which had been divided in the partition of the country. As a result of all these developments there was a steady rise in prices throughout 1947 and the earlier months of 1948. Towards the end of 1948 it became clear that immediate action should be taken to prevent, as far as possible, the further flow of purchasing power in the hands of the community and measures concerted to stimulate production and instil a spirit of confidence in industry. With this end in view, in the field of taxation, additional duties on certain articles of luxury such as liquor, tobacco, motor cars, silk and art silk fabrics were imposed and an excise duty on fine cloth was levied. Power was taken to make provisional assessments of income-tax on the basis of returns submitted by assessees and a system of interest bearing deposits for income-tax, introduced in the war years, was revived. The refund of deposits of Excess Profits Tax, except for approved purposes, was postponed for a further period

of three years. A temporary limit was also placed on the amounts that may be distributed as dividends by public companies. Import duties on machinery and certain industrial raw materials were reduced and the import duty on cotton yarn was abolished. New industrial undertakings commencing production in the next three years were given exemption from income-tax for the first five years upto a limit of 6 per cent. of their capital. The rules regulating depreciation allowances were also liberalised. Public expenditure, particularly capital expenditure, was substantially reduced while the State Governments were warned that they would have to rely on their own resources for implementing their schemes of social reform without assistance from the Centre. These measures had, on the whole, a steadying effect on the situation.

3. The economic conditions in India, as reflected in the price trends, fall into three distinct phases during the calendar year 1949. In the first three months, the measures adopted by Government proved most effective and the Economic Adviser's index number of wholesale prices which stood at 383·6 at the end of December 1948, fell rather sharply to 370·2 in March 1949. From April 1949, however, a reverse trend set in, and in the next six months there was a continued rise. This upward phase coincided with the grant by Government of increases in the prices of certain controlled commodities like cloth and steel as well as with the reimposition of stringent measures of control over imports. The general index number moved up from 370·2 in March 1949 to 393·3 in October, a rise of about 6 per cent. in the course of about six months. The third phase, which is one of improvement since November, was associated with the various measures adopted by the Government after devaluation in pursuance of their eight-point programme of 5th October, 1949. During this period, the general index number declined by about 3 per cent. from 393·3 in October to 390·2 in November and again to 381·6 in December, which is slightly lower than the level reached towards the end of 1948.

This figure is the net result of a number of factors and it will be interesting to analyse the movement of prices in individual commodities and groups of commodities. Taking the indices of food articles, there has been a steady decline in the prices of cereals and pulses, the index number of the former showing a fall of 55 points from 490 points in December 1948 to 435 points in December 1949, while the index number of the latter shows a drop of 72 points from 454 points

in December 1948 to 382 points in December 1949. The index number of food articles as a whole has shown a drop of 23 points in this period. The index number of semi-manufactured articles has, during last year, remained more or less steady, as also those of manufactured articles, the former showing a small increase of 7 points during the year and the latter a drop of 3 points. Among manufactured articles textiles registered a drop of 17 points. The only sector in which there has been an upward trend in prices is industrial raw materials, the index number of which has shown a rise of 20 points.

4. The entire policy of Government in the economic field came under detailed review last September when the devaluation of the rupee and the poor response of the market to Government's borrowing operations underlined the need for action to secure that further impetus was not given to the inflationary trends and an eight-point programme for meeting the altered situation was announced early in October. This programme envisaged the formulation of the future pattern of trade to secure economy in the expenditure of foreign exchange with due regard to the essential needs of the country, the employment of the country's bargaining power as a large scale purchaser to get a reduction to reasonable levels of prices of raw materials imported from countries with appreciated currencies, the prevention of speculative price increases by legislative and administrative measures and the regulation of credit facilities, the imposition of customs duties on articles exported to hard currency areas so as to ensure the maximum amount of foreign exchange and the equitable distribution of the advantage resulting from devaluation among the foreign importer, the Indian manufacturer and the public exchequer, the stimulating of investment by an intensified savings drive by propaganda and, failing this, by compulsion and by provision of suitable Governmental assistance for the extension of banking facilities in rural areas, the extension of facilities for voluntary settlement of taxes payable in respect of war profits of assessees whose cases had not been referred to the Investigation Commission, the introduction of economy measures to secure substantial savings in the current year's budget and the budget for the coming year and, lastly, the taking of steps, in consultation with the State Governments, for bringing about an aggregate reduction of 10 per cent. in the retail prices of essential commodities, including manufactured goods and foodgrains. Among the measures taken under this programme may be mentioned the increase in the

export duties on raw cotton and hessian, the former from Rs. 40 per bale to Rs. 100 per bale and the latter from Rs. 80 per ton to Rs. 350 per ton, the levy of export duties on mustard oil and certain categories of iron and steel, the reduction in the price of cotton textiles and yarn by a cut in the ex-mill prices and the margin allowed for distribution, and, more recently, by the reduction in the level of excise duties on cloth, the reduction in the price of pig iron and the selling prices of all categories of iron and steel and the reduction in the price of certain categories of coal and the grant of coal freight concessions to certain industries. As regards food-grain prices, Government have decided to effect a reduction ranging from 3 per cent. to 15 per cent. in the issue prices, to be secured partly by a reduction in distribution and other incidental charges and partly by the lowering of procurement prices. The cumulative effect of the measures taken to secure a reduction in the price level will take some time to be realised but they have already contributed towards holding the price level in recent months.

5. In the field of production, the results achieved last year give grounds for sober satisfaction. Industrial production has, on the whole, showed a definite upward trend, substantial increases over the previous year being recorded by the steel, cement, coal, aluminium, electrical, bicycle, chemical and paper industries. Steel production rose from 854,000 tons in 1948 to 925,000 tons, cement from 1·5 million tons to about 2 million tons, coal from 29·9 million tons to 31·09 million tons, paper from 97·9 thousand tons to 103·8 thousand tons, power alcohol from $3\frac{1}{2}$ million gallons to 6·7 million gallons, super-phosphates from 21,000 tons to 43,000 tons and Diesel engines from 1,025 to 2,048. Cotton textiles and jute, however, registered a decline, the production of cotton textiles dropping from 4,338 million yards to 3,919 million yards, cotton yarn from 1,445 million, lbs. to 1,306 million lbs. and jute manufactures from a little over a million tons to 926,000 tons. The drop in textile production was due partly to the accumulation of stocks and partly to difficulties in securing adequate supplies of cotton, to meet which Government are taking steps to import the necessary cotton from overseas, while the drop in jute production was due to special difficulties in obtaining the raw material. Recent trends in jute production, however, show a welcome increase, in spite of the difficulties in the way of obtaining supplies of raw jute from East Bengal.

6. The production of foodgrains in 1949 has also shown an increase over the previous year. Food production in 1949 is estimated at about 43 million tons as against 41 million tons in 1948. Procurement has been upto expectation, the figures for the 11 months ending November 1949 being 4·2 million tons against a target of 4·6 million tons for the whole year. The drive for self-sufficiency in food is being vigorously pursued both by the Central and State Governments and production in 1950 is expected to show an increase of 2·8 million tons over that of 1949 while the procurement target for that year has been raised by a further million tons over the target fixed for 1949, with a corresponding decrease in imports from overseas. Imports next year are now placed at $1\frac{1}{2}$ million tons of which approximately 200,000 tons would go to build up a reserve.

7. Steps are also being taken to raise the production of other agricultural products, notably jute and cotton. The production of jute in 1949 is estimated at 30 lakhs of bales against 20 lakhs of bales in the previous year while the target for next year has been fixed at 50 lakhs of bales, the increase to be achieved partly by double cropping and bringing fallow land under cultivation and partly by extending cultivation. Cotton production, which amounted to 28 lakhs of bales in 1949, is to be raised to 36 lakhs of bales in 1950. The production of tea, which is one of the country's main export crops, has also shown a welcome increase, reaching, at 587 million pounds, the highest figure in the last six years.

8. The increase in production, which has been a reassuring feature in 1949, has been largely assisted by a notable improvement in the labour situation, a striking evidence of which is the fact that for the eleven months ending November last the number of man days lost was only 60 lakhs, compared with 73 lakhs in the corresponding period of 1948. It has also been assisted by the continuous improvement in the transport situation which has made it possible for Government to lift the control on priorities.

9. Conditions in the money market were of exceptional stringency at the commencement of the year. There was a considerable strain on the banking resources of the country in the early months of the year as a result of the heavy demands for finance to cover the large imports of goods and the substantial collections of income-tax. Bank deposits fell continuously and with the rapid rise in advances during the busy

season, banks had to work with low cash ratios. These tight conditions continued longer than usual and in the first week of May 1949, the credit outstandings of scheduled banks reached a peak of Rs. 514 crores. The position began to ease from June 1949 when there were perceptible signs of improvement. The advances and bills discounted of scheduled banks declined continuously by Rs. 97·76 crores over the next eight months. In July the position was further eased by the repayment of the outstanding balance of the 2½% loan 1949-52 and it became possible to resume the sales of Central Government treasury bills, which had been suspended in November 1948, and by the end of September bills for Rs. 36 crores had been sold. Sales were then stopped to be resumed in December when a further sum of Rs. 2·76 crores was realised. Just as the advent of the slack season had been delayed, the impact of the busy season did not make itself felt till much later than usual, owing partly to the difficulties which arose in regard to the trade with Pakistan, and it was only towards the close of December that busy season activity became perceptible. Short-term funds being no longer available sales of treasury bills were again suspended.

10. In the first ten months of the current year the sale of Treasury Deposit Receipts has amounted to Rs. 13·02 crores and discharges to Rs. 5·14 crores, the outstanding balance at the end of January 1950 amounting to Rs. 11·76 crores. Thus, the total short term borrowings by the Central Government amounted to Rs. 45 crores as compared with nearly Rs. 48 crores during the corresponding of last year. In addition, Provincial Governments sold treasury bills worth Rs. 13·5 crores from August to November.

11. The gilt-edged market remained fairly steady during the year but there was no appreciable demand for fresh investment. The position in this respect has slightly improved in recent months and recently a further block of the 2½% Loan 1955, amounting to Rs. 15 crores, was issued to enable the Reserve Bank to meet this demand. Although the 1949-52 Loan was repaid during the year no fresh loans were floated in view of the continuous stringency in the money market. Demands for investment and for the conversion of the maturing loan were, however, met by the issue of fresh blocks of the 2½% loan mentioned above.

12. The devaluation of the rupee and the brighter prospects it held for indigenous industries gave a fillip to equity prices which, after sagging in the earlier months of the year, had slightly improved from the middle of July. In recent months, prices of a number of leading industrials have shown gains over the mid-July levels. This is reflected in the rise in the index number of yields of industrial securities which rose in December 1949 to 115·9 points from 109·7 points in July 1949. On the whole, both in the equities and the gilt-edged markets, investment enquiry appears to be broadening and there are signs of a return of confidence.

13. The inadequate response to Government borrowing in the early months of the year, together with the need for countering the threat of rising inflation arising out of the devaluation of the rupee, compelled Government last October to review the entire field of expenditure with reference both to the reduced sources likely to be available and the necessity for curtailing expenditure as a measure of anti-inflation. Instructions were accordingly issued to all the Ministries to effect a reduction in their administrative expenditure. The provision for expenditure on capital and development schemes was reviewed and the provision for the current year and for the next year was substantially reduced. The revised provision for the current year and the provision in the budget for 1950-51 are explained in a latter part of this Paper. In effecting these economies the need for continuing productive schemes and schemes of long term benefit to the country was kept in view. While this reduction in capital and development expenditure will delay, to some extent, the implementation of the various development plans this step had to be taken in the larger economic interests of the country as a whole.

Balance of Payments

14. India's foreign exchange reserve consists mainly of the sterling assets held by the Reserve Bank of India. These assets, which stood at Rs. 1,537 crores at the end of June 1948, declined to Rs. 820 crores at the end of June 1949, a drop of Rs. 717 crores. To this figure should be added the sterling equivalent of the dollar purchases made during this period from the International Monetary Fund, amounting approximately to Rs. 19 crores, giving a total external payment of Rs. 736 crores.

15. This heavy outgo is due to a number of factors. The first is the payment to the United Kingdom Government of Rs. 296 crores, in accordance with the agreement reached with them in July 1948, for the purchase of annuities for financing the payment of sterling pensions and for the acquisition of installation and stores left behind by them in India at the end of the war. The second is the payment of about Rs. 187 crores to the State Bank of Pakistan towards her share of the balances following the separation of Pakistan currency from that of India. These two special payments amounted to Rs. 483 crores. The remaining amount represents payments on current transactions, mostly on account of the heavy adverse balance of trade which was caused by increased imports and a small recession in exports particularly during the first six months of 1949.

16. The main reasons for a rise in imports were the large overseas purchases of foodgrains and the measures taken to liberalise commercial imports. Unfortunate weather conditions during 1948 had led to a partial failure of crops in several parts of the country and caused an abnormal deficit, necessitating increased imports of foodgrains. Of the total imports amounting to Rs. 650 crores during the period July 1948 to June 1949, the import of foodgrains accounted for as much as Rs. 137 crores constituting 21 per cent. of the imports. Commercial imports also showed a large increase. Import restrictions had been relaxed during the latter part of 1948, as an anti-inflationary measure and to meet the shortage of industrial and essential consumer goods. The chief items of import on commercial account during July 1948 to June 1949 were Rs. 90 crores of plant and machinery, Rs. 71 crores of raw cotton, Rs. 44 crores of motor spirit, kerosene and other petroleum products and Rs. 34 crores of steel and non-ferrous metals. These imports constituted 39 per cent. of the total imports. Other industrial goods were also imported in large quantities. Among these may be mentioned chemicals, dyes and colours, electrical goods, wood and timber, woollen and art silk yarn etc. Broadly, industrial goods and foodgrains amounted to 80 per cent. of the imports and consumer goods, many of them of an essential character like powdered and condensed milk, fruits, spices etc. accounted for the remaining 20 per cent. of imports. What may be termed as luxury imports accounted for less than 2 per cent. of the total imports. Exports during January-June 1949 were Rs. 197 crores as against Rs. 215

crores during the corresponding period in 1948. This fall in the export trade was almost entirely due to lower exports of jute and jute manufactures owing to a reduction in orders received from the U.S.A. during the period of business recession in that country.

17. This large adverse balance in payments during the period from July 1948 to June 1949 led to an overdrawal of about £81 million from the sterling balances. The sterling balance agreement of July 1949 regularised this overdrawal and provided for an increase in the annual release for the years 1949-50 and 1950-51 from the original figure of £40 million, as agreed to in July 1948, to £50 million. Further the new agreement provided for a special release of £50 million for 1949-50 to finance the imports that might be made during this year against commitments entered into by trade before the liberal import policy was reversed.

18. It was obvious that the country could not afford to have such a large adverse balance in her external payments. Measures reversing the policy of liberal imports were therefore introduced in May 1949 when the Open General Licence for the soft currency areas was cancelled, shipments against commitments made under this license being permitted only till the end of May and thereafter only on a special scrutiny of the individual commitments and with due regard to the essentiality of the commodity concerned. After the conclusion of the sterling balance talks with the U. K Government in July 1949, further restrictions were imposed on licensing of imports and appropriate ceiling limits were fixed for the licesing of imports of nearly all commodities. In the meantime, in common with similar action taken by all sterling area countries, dollar licensing was totally suspended from the last week of June 1949 to the first week of September, in order to safeguard the position of the Central Reserves of the sterling area against excessive depletion. The export trade began to look up, more especially after the devaluation of the rupee in September 1949. Imports of foodgrains were also restricted. These factors have been reflected in the variations in the sterling assets during recent months. The balances which stood at Rs. 320 crores at the end of June 1949, declined to Rs. 776 crores during the first week of September; since then they have gradually risen to Rs. 832 crores towards the end of January 1950. Thus there has been a small surplus of Rs. 12 crores during a period of seven months. This accumulation has been

caused mainly because of the temporary suspension of dollar licenses and the late issue of import licenses for the July December 1949 licensing period, which could be undertaken only after August 1949, when the foreign exchange limits for the issue of licenses were finalised. As imports against these licenses and against the licenses that are now being issued for January-June 1950 period start coming in and are paid for, the external payments are likely to increase; but with the limitations placed on imports, it is expected that it will be possible to meet these payments from the exports earnings and the agreed amounts of release from the sterling balances.

19. These changes in the external assets of the country indicate the need for a countinued vigilance on the balance of trade. The level of export earnings depends largely on the extent of production and the level of prices of the main exportable commodities and an improvement can be expected, so long as our exports continue to be competitive. In respect of imports, it is necessary to curtail the dependence on foreign sources for the major essential needs of the community, more especially in foodgrains and the main industrial materials. In either case increased production in both agricultural and industrial sectors at reasonable prices provides the solution to a healthy external economy.

Dollar position

20. The Sterling Balances Agreement of 1948, permitted a convertible release of 60 million dollars from the Central Reserves for a period of twelve months ending with June 1949. The estimated deficit was 160 to 180 million dollars and the balance was expected to be met by the purchase of 100 million dollars from the International Monetary Fund. Owing to a fall in the export earnings, the final deficit was 213 million dollars, and as only 56 million dollars could be purchased from the International Monetary Fund, there was a net overdrawal of 80 million dollars from the Central Reserves, after utilising 17 million dollars from the opening balance. This overdrawal was regularised by the Sterling Balances Agreement of July 1949.

21. Under this last agreement, India has become a full member of the sterling area with all the rights and obligations of such membership. There is now no quantitative limitation on the drawings from the Central Reserves to meet the dollar deficits. The convertibility arrangements

which were arrived at the Commonwealth Finance Ministers' Conference in July 1949, envisaged that, in common with the other sterling area countries, India's imports from the dollar area during the year July 1949-June 1950 will be limited to 75 per cent. of the dollar imports during the calendar year 1948. During the six months, July-December 1949, for which preliminary figures are available, India's dollar receipts have actually exceeded the dollar payments by 13 million dollars. This improvement is, however, purely temporary, accounted for by larger export earnings and a considerable decrease in payments. Owing to the business recession in America in the second quarter of 1949 and consequent reduction in the volume of orders received from that country, the demand for jute goods had piled up, while stocks accumulated with traders and mills in India. With the revival of business in the United States, larger orders covering both current requirements and the shortfall in previous orders were received, resulting in heavy exports and larger earnings during the half-year July-December 1949. The rate of dollar spending during this period was also low owing to the complete suspension of dollar imports with effect from the 25th June 1949 for a period of about 2½ months, and cessation of purchase of foodgrains from hard currency areas. The present improvement in the position is thus largely due to these purely temporary factors. The future trends will be determined mainly by the level of the demand for India's goods in the dollar areas and the availability at economic prices of adequate supplies of raw jute for the jute mills to meet this demand. Meantime, the convertibility arrangements under the sterling balances agreement and the stoppage of foodgrain purchases in dollar areas have made it possible to permit reasonable imports from dollar areas of commodities which are not available from soft currency countries and which are essential for the minimum needs of the country's economy and for industrial and agricultural production.

Loans from the International Bank

22. India has been able to obtain two loans so far from the International Bank for Reconstruction and Development, one of 34 million dollars for the purchase of locomotives for railways for rehabilitating the transport system and another of 10 million dollars for the purchase of agricultural machinery to bring weed-infested land under food cultivation. A

third loan of about 20 million dollars for the Bokaro Thermal Plant of the Damodar Valley Project is at present in the final stages of negotiation. The imports from the dollar area financed from these loans will be in addition to the imports at 75 per cent. of the 1948 level.

Devaluation of the Rupee

23. The circumstances in which the Government of India decided to devalue the rupee in terms of gold are well known. When last September the U.K. decided to devalue the pound sterling in terms of gold and other members of the sterling area and certain other countries followed suit, it became necessary for India to take parallel action, as a protective measure against a diminution of her export trade by the pressure of competing exports from countries that had devalued their currencies. Though it is too early yet to assess precisely the ultimate effect of devaluation on export earnings generally, the results so far have been encouraging, as the following figures will show.

	Value of Exports (In crores of Rs.)
Quarterly average for *1948.*	107·08
1949	
First quarter	103·13
Second quarter	94·16
Third quarter	100·66
Fourth quarter	139·97

During the months of November and December 1949, exports have touched a record level of Rs. 50 crores per month; raising the level of exports to Rs. 241 crores during the half-year July-December 1949, against Rs. 216 crores during January-June 1948, Rs. 213 crores during July-December 1948 and Rs. 197 crores for the first half of 1949. Noticeable increases have taken place in the exports of tea, spices, cashewnuts, unmanufactured tobacco, cotton and jute textiles. Exports of cotton textiles in particular were more than doubled. The devaluation of the rupee has obviously made many of our commodities competitive in price in the export market and has led to increased orders from overseas. While these increases in exports are partly due to temporary factors, which have already been mentioned, there is reason to hope that the increase in demand for many of these export commodities may be more than a passing phase.

Appreciation of Pakistan Currency.

24. Pakistan, although a member of the Sterling Area decided not to devalue her currency along with the other countries of the Sterling Area with the result that her currency appreciated both in terms of the Indian rupee and the pound sterling although details of her balance of trade and payments show that Pakistan also had a large adverse balance of trade, particularly with countries other than India.

25. Statistics of trade published by the Pakistan Government show that for the twelve months ending June 1949, Pakistan's exports to countries other than India were Rs. 60 crores and imports from these countries were Rs. 88 crores showing an adverse balance of trade of Rs. 28 crores. Private trade with dollar and hard currency countries of the Western hemisphere, Belgium, Switzerland, Germany and Japan gave a favourable balance of Rs. 5 crores, the deficit in soft currency trade being Rs. 33 crores.

26. These figures, however, do not include imports on Government account as the Government of Pakistan do not record such imports in their published statistics. Their statistics do not also include exports of Pakistan goods in the transit trade through Calcutta. It is understood that imports on Government account during this period were as much as Rs. 50 crores. Exports in transit through Calcutta amounted to Rs. 16 crores. Thus, the total deficit with countries other than India was of the order of Rs. 63 crores, imports being Rs. 139 crores and exports Rs. 76 crores. The overall deficit is equivalent to roughly 45 per cent. of the import trade and 81 per cent. of the export trade. It is nearly 30 per cent. of the total trade. Private trade with hard currency areas showed a favourable balance of Rs. 5 crores; but Pakistan is believed to have purchased military and other stores on Government account from Belgium and Canada. Accurate statistics of these purchases are not available but it would not be unreasonable to conclude that even in the trade with the hard currency countries, if imports on Government account are included, Pakistan does not have a favourable balance of trade. Taking the dollar area alone, as distinct from the hard currency areas, Pakistan's dollar deficit during the period was of the order of 50 million dollars.

27. These figures may be compared with the balance of payments as assessed from the changes in the sterling assets

of the State Bank of Pakistan during this period. The total sterling assets received by the State Bank of Pakistan, during the period between 1st July 1948 and 30th June 1949, from the Reserve Bank of India as part of their share of the assets were Rs. 200 crores. Their balance of these assets on the 1st July 1949 was Rs. 150 crores, showing a net fall of Rs. 50 crores. Pakistan received Rs. 11 crores in sterling on account of current transfers from India during this period. Thus Pakistan's loss of sterling to countries other than India amounted to Rs. 61 crores.

28. A comparison with India's balance of trade with countries other than Pakistan would be interesting. According to payments statistics of the Reserve Bank of India for July 1948 to June 1949, India's payments to countries other than Pakistan on account of imports were Rs. 621 crores and her receipts on account of exports Rs. 378 crores, giving a net deficit balance of Rs. 243 crores, equivalent to 39 per cent. of the value of imports, 64 per cent. of the value of exports and 22 per cent. of the total trade. As stated above, corresponding figures in respect of Pakistan's trade with countries other than India are 45 per cent., 81 per cent. and 30 per cent. respectively. Exclusive of the trade between the two countries, Pakistan's balance of trade problem was thus no less serious than that of India.

Trade between India and Pakistan

29. Accurate statistics are not available in respect of trade between India and Pakistan but certain estimates prepared show that during the 12 months from July 1948 to June 1949, imports from Pakistan into India were Rs. 117 crores and exports to Pakistan from India were Rs. 83 crores, giving a balance of Rs. 34 crores in favour of Pakistan. A part of this deficit was financed by a flow of capital from India and the remaining Rs. 11 crores by transfer of sterling to the State Bank of Pakistan under the Payments Agreement.

30. Of the total Indian imports from Pakistan of Rs. 117 crores, as much as Rs. 97 crores were imports of raw jute and cotton. These large purchases of raw materials have therefore contributed to Pakistan's favourable balance of trade with India. There were also other factors. While India had an open general licence for all Pakistan goods, Pakistan had been restricting imports of Indian goods. Pakistan's

imports of cotton textiles from India amounted to no more than Rs. 18 crores in this period. Before the partition, the areas now in Pakistan used to take as much as 900 million yards of cloth from the Indian mills. The restricted import policy of Pakistan reduced this trade to nearly 25 per cent. Besides, the imposition of export duties on cotton and jute and of import duties on Indian textiles and other Indian commodities also affected the balance of trade by pushing up the value of cotton and jute supplies to India and by reducing imports of textiles from India. Further, a number of claims made on the Pakistan Government for payment such as those for defence stores supplied to Pakistan were still outstanding at the end of this period. If these claims had been met, Pakistan's favourable balance of payments with India would have been correspondingly reduced.

31. The figures mentioned above would show that even with her favourable balance of trade with India, Pakistan had an adverse balance in her total trade.

Deficit with other countries .....Rs. 63 crores.

Surplus with India.....Rs. 34 crores.

Net deficit .....Rs. 29 crores made up of—

Total imports—Rs. 139+ 83 crores=Rs. 222 crores.

Total exports—Rs. 76+117 crores=Rs. 193 crores.

It is possible that in not devaluing her currency, Pakistan reckoned on a continuation of and an increase in this favourable balance of trade with India. Pakistan may have thought that by appreciating her currency in relation to the Indian rupee, her balance of trade would be yet more favourable. Indian goods could be bought cheaper than before whereas India could not afford to do without Pakistan's raw materials in spite of the increase in their prices caused by the change in the value of the currency. It is significant that soon after devaluation, Pakistan totally banned the import of Indian textiles and raised the import duties on these and many other commodities. If Pakistan hoped to increase her favourable balance of trade with India by appreciating her currency, there are indications that this expectation is not likely to be realised. The high prices of her raw materials have resulted in Indian mills refraining from buying these materials from Pakistan and the trade between the two countries has virtually come to a standstill. Even when trade is resumed,

India will inevitably have to take steps to reduce her trade deficit with Pakistan. Pakistan has incurred a large partition debt to India, of the order of Rs. 300 crores, the repayment of which is to begin in 1952. India's claim for settlement of evacuee property would also result in Pakistan having to pay large amounts to India. Taking these factors into account, Pakistan can hardly count on her favourable balance of payments with India to finance part of her larger deficit with other countries.

32. As a result of non-devaluation, Pakistan's trade with other countries has already shown signs of a decline. During the last three months of 1949, Pakistan's sterling assets have gone down by as much as £ 10 million. Her main exports are raw jute, raw cotton, raw wool, hides and skins, and tea. Indian manufacturers having refrained from buying raw jute, the jute prices themselves have already been reduced. The demand from countries other than India is small. Indian exports of raw jute, although limited in quantity, are more competitive. For hides and skins again, India is the main market. The prices in Pakistan are believed to have come down to about one-third of the pre-devaluation price. For raw cotton, although prices in other cotton markets have gone up, the price of Pakistan cotton has remained stationary. For raw wool, Australia, with her devalued currency, is a serious competitor. The Pakistan Government themselves seem to have recognised a possible decline in the trend of exports in as much as they have cancelled their OGL and have taken measures to severely restrict imports. Sometime ago, Pakistan's Finance Minister stated that in view of the inelasticity in her main export commodities, Pakistan's decision not to devalue her currency was expected to be of benefit to the sterling area inasmuch as Pakistan would continue to earn the same amount of dollars as before. All data available indicates that this expectation is not likely to be realised and in fact Pakistan's earnings of dollars have seriously declined during the period following the appreciation of her currency.

33. The available statistics analysed above clearly show that :—

(i) Pakistan's balance of trade problem for trade with countries other than India is no less serious than that of India; her adverse balance of trade with these countries was larger than her favourable

balance with India for the period July 1948 to June 1949.

(ii) Since July 1948, Pakistan's external assets have been declining even more rapidly than those of India and while after the devaluation of Indian currency, India's external assets have improved, Pakistan's assets have gone down further.

(iii) Pakistan's favourable balance of payment and trade with India was due mainly to India's open-door policy in respect of imports from Pakistan, Pakistan's restriction on Indian imports, certain fiscal measures taken by her in respect of trade with India and delays in settlement of Government claims.

(iv) Pakistan's appreciation of her currency would appear to have been made with a view to increasing her favourable balance with India by worsening the terms of trade against India.

(v) If trade with India is balanced as a result of any action taken by India in self-protection, Pakistan's balance of payments problem will seriously deteriorate.

(vi) Pakistan's claim that by maintaining the value of her currency she expected to maintain her dollar earnings is not borne out by the recent trend of events. In fact her contribution to the dollar pool of the sterling area is likely to decline quite substantially.

(vii) There are clear indications that although India has kept off buying Pakistan goods, Pakistan's export trade to other countries is on the decline, partly as a result of a reduction in the price levels of her main export commodities and partly as a result of reduced volume of exports.

Trade relations with Pakistan

34. Pakistan's decision to appreciate her currency *vis a vis* both the Indian rupee and sterling has led to a virtual suspension of trade between India and Pakistan. The appreciation of Pakistan currency made it clearly uneconomical for Indian manufacturers to buy their raw materials, principally jute, from that country in the interest of maintaining their export market and they had inevitably to refrain from buying in

Pakistan. This was no measure of retaliation but one of obvious protection against having to pay higher prices for their raw material. Nevertheless, a limited volume of trade continued to flow in both directions, either on the basis of barter or on the basis of free exchange rates, which were frequently only a small margin away from parity. These transactions were limited in volume, as, although there were no restrictions on the financing of trade through normal banking channels, many banks in both countries were unwilling to hold or acquire any appreciable quantity of the overvalued Pakistan currency. Even this limited trade has been brought to a standstill by certain measures taken by the Pakistan Government such as the prohibition of exports without production of evidence of payment at the official rate of exchange announced by them and the banning of transactions in Pakistan between the two currencies otherwise than at the official rate announced by them. There has been some correspondence between the two Governments on the subject of the revival of trade between the two countries. The Government of India have throughout expressed their willingness to discuss all issues relating to financial and trade matters but such discussion has been made impossible by Pakistan's insistence that neither the exchange rate nor the floor prices for jute fixed by them should be discussed. It will be appreciated why under these conditions no progress has been possible towards the restoration of normal trade relations between the two countries.

35. There is, however, one conclusion it is difficult to escape. The integrated economy of undivided India has inevitably been affected by the partition and although one may continue to hope that the old pattern of trade between the two countries would be re-established, India cannot afford to remain dependent on an outside source for the essential raw materials of the country's main industries *viz.* jute and cotton. Apart from the risk involved in such a course, which recent events have underlined, this dependence also means a considerable expenditure of foreign exchange. It is, therefore, in the long term interests of the country to increase the internal production of jute and cotton and the steps taken in this connection have already been referred to.

Financial Year, 1949-50

36. For the current year, against a nominal surplus of Rs. 49 lakhs provided in the budget, there is likely to be a deficit of Rs. 3·74 crores.

Revenue

37. The revenue receipts are now estimated at Rs. 332·36 crores compared with the budget estimate of 323·02 crores, an increase of Rs. 9·34 crores. Receipts under Customs show an improvement of nearly Rs. 9 crores due to a phenomenal increase in imports during the earlier months of the year, the increase in the export duty on jute, and the levy of export duties on mustard oil and pepper during the course of the year. This increase will be partly set off by a reduction in revenue in the closing months of the year, as the result of the reimposition of import controls, by the abolition of the export duty on cotton cloth and the reduced yield from the export duty on raw cotton. The revenue from Union Excise Duties is not expected to differ materially from the budget. Income-tax receipts are now estimated at Rs. 149 crores, and the Provincial share of income-tax at Rs. 40·74 crores, to which a sum of Rs. 5 crores will be added for the payment of arrears carried over from last year. The contribution from the Posts and Telegraphs Department is now estimated at Rs. 377 lakhs (Rs. 70 lakhs less than estimated) while, following the improvement in Railway earnings, the Railway contribution has been raised from Rs. 4·72 crores to Rs. 7 crores. Miscellaneous heads of revenue are expected to show an increase of Rs. 2½ crores.

Expenditure

38. The revised estimate of expenditure in 1949-50 is placed at Rs. 336·1 crores of which Defence Services account for Rs. 170·06 crores and Civil estimates for Rs. 166·04 crores.

39. *Defence Services.*—The expenditure on Defence Services this year is likely to be Rs. 12·69 crores more than the Budget estimate of Rs. 157·37 crores. It was made clear at the time the Budget for the current year was introduced that it had been framed in the hope that the 'Cease-fire' in Kashmir would eventually lead to a peaceful solution of the problem but that if, for any unforeseen reason, this hope was not realised it may be necessary to exceed the budget provision. It was only in July-August 1949, nearly eight months after the 'Cease-fire', that the 'Cease-fire' line was agreed upon and demarcated and since then there has not been much progress towards the conclusion of a truce agreement or the progressive withdrawal of the enemy forces from Kashmir. In

these circumstances an increase over the original Budget provision is inevitable. Actually, the increase would have been somewhat greater but for certain measures of economy introduced during the course of the year.

40. *Civil Estimates*.—The net increase of Rs. 88 lakhs in Civil expenditure is the result of a number of increases and decreases of which the more important may be mentioned here. The revised estimate includes a provision of Rs. 257 lakhs for the payment to the Saurashtra Union, of compensation for the period ending 31st March 1950, for the surrender of the customs rights and administration, which were taken over by the Central Government on the 15th July 1948 and for the removal of the Viramgam Cordon. It also provides Rs. 99 lakhs for payment to Provinces and States of the Central share of expenditure on the preparation of electoral rolls for the new Parliament. Increased expenditure is expected under Civil Works and on the strengthening of the Audit Department to enable it to cope with the increased work and restore the pre-war standards of audit. Additional expenditure of over Rs. 3 crores is also expected on the relief of displaced persons and of Rs. 3,45 lakhs in the expenditure on the payment of bonus to Provincial Governments for internal food procurement. These, and other minor increases under other heads, will be partly set off by a saving of Rs. $6\frac{3}{4}$ crores in the provision of Rs. $28\frac{3}{4}$ crores for the payment of subsidy on imported foodgrains. A saving of Rs. 1,08 lakhs is also expected as a result of the decision to recover from the sale proceeds of surpluses the cost of the Disposals organisation.

41. *Financial Integration with Indian States*.—Before passing on to the estimates of the coming year, a brief account may be given of the changes in the pattern of the fiscal and financial relationship between the Centre and the former Indian States. The process of reducing the number of these States and integrating them with either the neighbouring Provinces or forming them into sizable units has been going on steadily since the achievement of independence. A very large number of these States have either been merged in the Indian Provinces or formed into Chief Commissioners States (like Tripura, Manipur, Bhopal, Kutch, Himachal Pradesh, Bilaspur and Vindhya Pradesh). In either case they lose their identity and become part of a Province or a Centrally administered area. But where the States continue by themselves like Hyderabad or Mysore, or form separate

Unions like Saurashtra, Madhya Bharat, Patiala and East Punjab States Union or Rajasthan, the problem of reorienting their financial relationship with the Centre arose. To consider this problem a Committee was appointed in October 1948 under the Chairmanship of Shri V. T. Krishnamachari to enquire into the structure of public finance of these States and to advise on the integration of federal finance in those States with those of the Indian Union. The recommendations of this Committee have, with certain agreed modifications, been accepted by the Government of India and the Governments of the States concerned. The scheme of integration, which will take effect from the 1st April 1950, places the States and Unions in the same position as the Indian Provinces *vis-a-vis* the Centre. The present composite Governments of these States will be divided on a functional basis and the Centre will take over the Central subjects and services from these States with the related assets and liabilities. But since some of these States were financing what would be Provincial services from the surplus of their revenue from Central subjects some form of financial assistance to them to meet the dislocation caused by the lifting of federal revenue and expenditure from their budgets is obviously necessary. Following the Committee's recommendations, for a transitional period of ten years the Centre has agreed to make good (with certain adjustments) to the States the difference between the actual federal revenue lost to them and the federal expenditure saved to them as a result of federal financial integration. This reimbursement will be made in full for the first five years and on a diminishing scale for the next five years. The States will be in the same position as the Provinces in the matter of sharing divisible sources of revenue like income-tax but any grant made to them to cover the federal revenue gap will be set off against this share. States which are left with a surplus as a result of the integration will retain the surplus but the Privy Purses of the former Rulers of these States will be recovered from them to the extent of this surplus. They will, in addition, get their appropriate share of divisible heads of Central revenue. It will be some time before the "revenue gap" of these States can be determined but on the basis of the information now available it appears that assistance will be necessary to Hyderabad, Travancore-Cochin, Mysore and Saurashtra while Madhya Bharat, Patiala and East Punjab States Union and Rajasthan will not require assistance from the Centre.

The budget next year includes, under the various heads, the Central revenue and expenditure in these States and provision has also been made for the payment of Privy Purses to the former Rulers of the States and for grants to the States whose finances will be dislocated by federal financial integration.

42. A similar problem of adjustment has also arisen in the case of the former Indian Provinces into which a large number of Indian States, of varying sizes and in varying stages of development, have been merged. The Krishnamachari Committee enquired into this problem as it arose from the merger of Baroda in Bombay and they suggested that assistance should be given to Bombay on the same pattern as to the continuing States and Unions to meet the dislocation caused by federal financial integration. Government have accepted this suggestion and are applying it uniformly to all the Provinces in which Indian States have been merged and provision has been made in the budget for this assistance.

43. The problem of bringing the large number of Indian States into the common stream of the country's economic and financial life and of removing the barriers between them and the rest of the country has been defying solution for many years. The Krishnamachari Committee have rendered a most valuable service in assisting Government to find a solution acceptable both to the Centre and to the States. The integration of the States with the rest of the country, whatever the difficulties to the Centre and to the States in the transitional period, is bound to have a beneficent effect on the country as a whole. The people of these States will share with the people of the former Indian Provinces the same opportunities for progress and development and their Governments will be entitled to the same measure of assistance from the Centre as the Governments of the Provinces. Their assimilation with the rest of the country has made it possible, for the first time in the history of the country, to plan the progress and development of the country as a well-knit economic unit.

Financial Year, 1950-51

44. At the existing level of taxation the total revenue for 1950-51 is estimated at Rs. 347·5 crores and the expenditure charged to revenue at Rs. 337·88 crores leaving a surplus of Rs. 9·62 crores.

45. As mentioned earlier, as a result of federal financial integration, the estimates for 1950-51 include the revenue and expenditure under Central heads in the former Indian States

and provision for payments such as the privy purses or grants incidental to the integration. They also include the entire revenue and expenditure of such of these States as have been taken under direct Central Administration and constituted into Chief Commissioners' States. The estimates are, therefore, not comparable with those of the current year. During the current year, Central transactions in the merged States have been kept in a self-contained Deposit Account instead of being accounted for under the normal heads, as a measure of budgetary and accounting convenience, particularly as different States merged with the adjoining Provinces or came under Central administration on different dates. These deposits accounts will be closed at the end of the current year and the outstanding balances in them will be transferred to revenue or expenditure.

Revenue

46. The total receipts from Customs is estimated at Rs. 106·54 crores. The reduction over the current year's receipts is mainly due to the effects of the re-imposition of import controls this year in order to conserve foreign exchange and the changes in duties introduced during the current year. Union Excises are expected to bring in Rs. 71·55 crores, after allowing for the full effects of the reduction made on the 1st February 1950 in the excise duty on cotton cloth. Receipts from income-tax, which include Rs. 9·56 crores on account of Excess Profits Tax and Rs. 8·09 crores on account of the Business Profits Tax have been placed at Rs. 182·62 crores, the increase over the current year's revised estimate being due to the inclusion of Rs. 10·36 crores on account of revenue from the former Indian States, increased revenue as a result of the work of the Income-tax Investigation Commission and larger collection of arrears. The estimates also include a sum of Rs. 18·31 crores on account of income-tax revenue under Section 18-A taken direct to revenue instead of initially to a deposit head, under the accounting change which was introduced in 1948-49 and which will be completed in 1951-52. The divisible pool of income-tax is estimated at Rs. 108·78 crores and the shares of the former Indian Provinces at Rs. 54·39 crores. In addition, a sum of Rs. 81 lakhs is expected to be paid to the continuing Indian States, as the share of revenue of such of them as do not qualify for a grant-in-aid under the integration scheme. The contribution from the Posts and Telegraphs is estimated

at Rs. 4·48 crores. Under the arrangement between Railways and General Revenues, recommended by the Railway Convention Committee and approved by Parliament, Railways will, from next year, pay General Revenues a dividend of 4 per cent. on the capital at charge instead of interest plus contribution. The total payment by Railways will amount to Rs. 31·85 crores (against Rs. 30·15 crores received as interest plus contribution this year) of which Rs. 25·48 crores will be taken in reduction of the expenditure on interest and the balance of Rs. 6·37 crores as a contribution to revenue. Miscellaneous revenue is estimated at Rs. 9·79 crores against the current year's revised estimate of Rs. 7·82 crores, the increase being mainly due to the new Chief Commissioners' States.

Income-tax Investigation Commission

47. Among the factors explaining the increase in income-tax revenue in the coming year is the results of the working of the Income-tax Investigation Commission. The Commission have already submitted their report on the adequacy of the existing law to prevent evasion. Their recommendations are under examination and a Bill embodying the accepted recommendations will be placed before the Parliament in the current session. The Commission's recommendations in regard to administrative matters are also under examination and steps are being taken to recruit the necessary staff for the proper manning of the Department. A scheme for the expansion of the survey staff for finding out new assessees is also expected to be introduced early next year.

48. The Commission have also made substantial progress in the investigation of individual cases referred to them. Out of 1,365 cases referred to them the Commission have disposed of 116 cases on which a sum of about Rs. 2¼ crore is likely to be recoverable. In regard to the remaining cases the Commission have collected a vast mass of material and information and the cases may be expected to be speedily disposed of. In this connection it must be remembered that in most cases the Commission have to study the available records for a period of seven or eight years and make protracted enquiries relating to these years. The staff at the disposal of the Commission has been strengthened during the year and legislation enacted in the Indian States, always a safe sanctuary for black-market money, to enable the Commission to extend their investigation into these States.

Finance Commission

49. Before explaining the expenditure estimates it will be convenient to deal with the problem of allocation of revenues between the Centre and the States. Under the Government of India Act, 1935, as enacted, the Provinces were entitled to half the net proceeds of taxes on income (other than Corporation Tax) while the jute growing Provinces were sharing 62½ per cent. of the net proceeds of the export duty on jute and jute products. In addition, Assam, Orissa and N.W.F.P. were in receipt of lump sum grants-in-aid. After the partition of the country involving the transfer of two Provinces and parts of three Provinces to Pakistan, the Government of India made a fresh allocation of the Provincial share of income-tax and the export duty on jute among the Indian Provinces, while maintaining the general grants to Assam and Orissa, as the partition made the allocation under the 1935 Act unworkable. This allocation was criticised in certain quarters and Government came to the conclusion that in the interests of both the Centre and the Provinces the allocation should be re-examined, and determined, by an impartial authority, whose findings should regulate this matter till the Finance Commission consider it in due course. Shri C. D. Deshmukh, a former Governor of the Reserve Bank, was requested to decide the allocation and his decisions have been announced. These will regulate the allocation of income-tax and the payment of the grant in lieu of the jute export duty till the Finance Commission enquire into and decide these questions. Apart from the change in situation created by the partition of the country the financial position of the former Indian Provinces has also been radically altered by the merger in some of them of a larger number of Indian States, many of them backward and undeveloped. The independence of the country has also placed on the Centre an increased responsibility in the matter of defence. A fresh enquiry into the resources and needs of the Centre and the States, in the altered conditions created by the partition and the integration of the Indian States, now seems necessary and Government have decided that the Finance Commission provided in the Constitution should be appointed with the least possible delay. It is expected that the Commission will start functioning in the coming year and necessary steps in this behalf are being taken.

Estimates Committee

50. Unlike the Railway estimates which are placed before the Standing Finance Committee before their presentation to Parliament, the general budget is not examined by any Committee of Parliament. While it is not possible, because of the size and complexity of the general budget and the very limited time available between its completion and its presentation to Parliament, to have it scrutinised by a Committee of the House at that stage the suggestion has been made that the estimates should be examined by a Committee of the House after it has been passed by Parliament, so that Government may have the advantage of the detailed examination of these estimates on behalf of the House. It has been decided to invite Parliament to set up an Estimates Committee to scrutinise the estimates during the course of the year. The Estimates Committee will not be concerned with matters of policy and its main function will be to consider how economies in public expenditure could be effected consistent with the policy on which the budget has been framed. The suggestions of this Committee will assist the Government both in effecting economies during the course of the year and in framing the budget for the ensuing year.

Expenditure

51. The total expenditure next year is estimated at Rs. 337·88 crores of which Rs. 168·01 crores will be on Defence Services, Civil estimates accounting for the balance of Rs. 169·87 crores.

52. Details of expenditure on Defence Services are given in the Explanatory Memorandum circulated with the Budget papers and it is necessary to refer in this memorandum only to the broad features. The budgetted expenditure of Rs. 168·01 crores includes a provision of Rs. 8 crores for the pay, allowances and maintenance of the Indian States Forces to be taken over by the Centre on federal financial integration. These forces are being reorganised with a view to their training, equipment and establishment being brought up to the scale and standard of the rest of the Indian Army. At the same time, their numbers which increased considerably during the period of the war, are being brought down to a level considered necessary by the Defence authorities, taking into account the overall requirements for the security of the country. This process will take some time; but the main

changes are expected to be completed by the 1st April 1951. Once these forces are reorganised on the pattern of the Indian Army they will become indistinguishable from the rest of the Army.

53. Including the expenditure on the States Forces the expenditure for the coming year is two crores less than the revised estimate for the current year. This is the result of certain measures of economy which are proposed to be given effect to in the coming year. These measures have been most carefully considered in the light of all relevant factors and in deciding upon them the paramount requirements of the security of the country have been kept prominently in view. The estimate is based on the assumption that no unexpected developments affecting the country's security will occur.

54. **Civil Estimates.**—Details under individual heads are, as usual, gievn in the Explanatory Memorandum and only the more important items are referred to here. The estimates include a total provision of Rs. 3·42 crores on the administration of the Indian States which have been taken over as Chief Commissioners' States. They also include, under various heads, a sum of Rs. 6·69 crores on account of the expenditure on Central subjects in these States and in the continuing Indian States and Unions. The budget makes a provision of Rs. 4·51 crores for the privy purses of Indian Rulers and of Rs. 11·56 crores for grants-in-aid to the Provinces and States and Unions to cover the dislocation caused to them by federal financial integration. Excluding these special items the budgetted expenditure next year amounts to Rs. 143·69 crores compared with the revised estimate of Rs. 166·04 crores this year. Expenditure on the relief of displaced persons is estimated at Rs. 6 crores against Rs. 13·7 crores this year while the expenditure on the payment of subsidies on imported food grains and on procurement will amount to Rs. 21 crores, a reduction of Rs. 8·67 crores as compared with the current year. Expenditure on the payment of pre-partition liabilities has been placed at Rs. 2 crores against Rs. 6·6 crores in the current year.

55. Of the total expenditure of Rs. 169·87 crores provided in the budget for the next year, Rs. 30·34 crores are accounted for by special items such as relief of displaced persons, payment of food subsidies, expenses on the coming elections and pre-partition payments, the ordinary expenditure amounting to Rs. 139·53 crores. Of this Rs. 13·81 crores is on tax collection while obligatory expenditure such as payment of interest charges and pensions and provision for debt

redemption absorb Rs. 43·95 crores. Grants-in-aid to the former Indian States and the Provinces account for Rs. 15·4 crores. Allowing for the expenditure on Currency and Mint of Rs. 1·76 crores and the expenditure of Rs. 28·02 crores in the nation building spheres, such as Scientific Department, Education, Medical, Public Health etc., the balance of Rs. 36·59 crores represents the provision for administration, civil works, etc.

56. It is difficult to make a precise estimate of the effect on Central finances of the integration of the federal finances of the former Indian States with those of the Centre. A close estimate of revenue and expenditure can be made only after the Central subject in these States have been actually taken over. The amounts provided in the budget in the coming year are the best estimates possible at this stage. The amount of the grants to be made to the deficit States and Provinces to cover the revenue gap caused by federal financial integration also remains to be determined. But on a very rough computation, it is estimated that taking all services, including Railways, into account the net burden on account of the integration falling on the Centre is likely to be of the order of Rs. 9½ crores.

Capital Expenditure

57. In an earlier paragraph the circumstances in which Government were compelled to reduce the capital expenditure this year and to plan the provision for the coming year on a more modest basis than in the past has been mentioned. Against the current year's budget of Rs. 95 crores roundly for capital expenditure and Rs. 76 crores for loans and advances the revised estimate has made a provision of Rs. 75 crores for capital outlay and Rs. 76 crores for loans, the latter including Rs. 16 crores as temporary ways and means advances to certain States. Next year's budget includes Rs. 62 crores for capital outlay and Rs. 43 crores for loans and advances. The revised estimate for the current year includes a special payment of Rs. 79 crores to the International Monetary Fund and the International Bank for Reconstruction and Development. Following the devaluation of the rupee, India's subscription to the capital of these institutions and the payment made in rupee securities to the Fund for the dollar loan taken from it had to be raised to the required

amount at the altered rate of exchange. Nearly the whole of this payment has been made by the issue of non-interest bearing securities and it does not, therefore, affect the ways and means position now. Details of the various schemes for which provision has been made in the Capital Budget will be found in the Explanatory Memorandum. Among important items may be mentioned the provision of Rs. 20·83 crores this year and Rs. 19·49 crores next year for capital outlay on Railways, Rs. 3·82 crores this year and Rs. 5·64 crores next year for Posts and Telegraphs and Rs. 15 crores this year and Rs. 19 crores next year for the river valley schemes. Capital outlay on Defence will cost Rs. 12 crores this year and Rs. 8·15 crores next year while Rs. 9·55 crores will be spent this year and Rs. 9·63 crores next year on industrial development.

Ways and Means

58. The estimate of borrowing in the current year was based on the hope that there will be a material improvement in the capital market and in the realisations from small savings. Money conditions however remained stringent and this hope has not been realised. Market conditions did not allow the flotation of a regular loan but the investment demand has been met by the creation of further blocks of the existing 2½ per cent. Loan 1955. Against the estimated borrowing of Rs. 85 crores fresh borrowings this year have amounted to only Rs. 40 crores while the receipts from small savings are now estimated at Rs. 26 crores roundly against the budget estimate of Rs. 37½ crores. The drop has mainly occurred under Postal Savings Bank, the net receipts from which are likely to be Rs. 10 crores less than estimated. Discharges of National Savings Certificates have also been larger than estimated. The mobilisation of small savings and the development of the habit of saving in the rural areas, where the savings movement has made less headway than in the urban areas, is under active consideration and the recommendations of the Committee on Rural Banking on the extension of banking facilities in the rural areas are awaited. Meanwhile, every effort is being made by propaganda to spread the savings movement. The system of authorised agents for canvassing the sale of National Savings Certificates, which was abolished in 1948, is being revived as an experimental measure in the States of Bombay, Madras and West Bengal. The results of this will be carefully watched and the scheme extended to other States, if experience justifies it. Government have also

introduced a system of compulsory savings for their employees getting a pay of Rs. 250 and over through subscriptions to State Provident Funds. An extension of the scheme to lower paid employees is under consideration and is expected to be introduced shortly.

59. For next year, a modest estimate of Rs. 75 crores has been taken for market borrowings while the net receipts from small savings have been placed at Rs. 28 crores roundly. In addition to the 2½ per cent. Loan 1950, with an outstanding balance of a little over Rs. 35 crores, which falls due in July 1950, Government have the option of repaying the 4½ per cent. Loan 1950-55 of which the rupee outstandings amount to Rs. 6$\frac{3}{4}$ crores and the sterling outstandings to about a million pounds. As the loan carries a high rate of interest Government have exercised this option and the loan has been notified for discharge.

National Planning Commission

60. At the end of the last war a comprehensive scheme of post-war development was drawn up and a large number of development schemes have been undertaken both by the Centre and the States on the lines of this development plan. This plan was drawn up for undivided India and in the expectation that for the first five year period the total resources, taking revenue surpluses and borrowing together, will be of the order of Rs. 1,000 crores. The partition of the country and subsequent developments have radically altered the position and the available resources are unlikely to be of the magnitude contemplated some years ago. It has, therefore, become necessary to reconsider the position *de novo* and draw up a new plan for development taking into account the changes in the economic conditions in the country, the resources likely to be available and the situation created by the integration of the former Indian States with the rest of the country. The National Planning Commission which Government have decided to set up will deal with this problem. Meanwhile, to the extent to which the available resources permit, the execution of the development schemes on hand will go forward.

61. In view of the anticipated surplus of Rs. 9·62 crores next year the budget proposals do not include any fresh taxation.

Taxes on Income

62. In the sphere of direct taxation the first proposal is to abolish the Business Profits Tax. When this tax was introduced in 1947 it was designed, in a sense, to replace the Excess Profits Tax but in actual operation it applies even when there are no excess profits. The tax, for example, applies to a partnership the capital of which is Rs. 40 lakhs even if the profits are as low as 6 per cent. while if each of the partners decided to do business independently and make as much as 10 per cent. there would be no liability to pay this tax. In its application to companies the tax affects only the entrepreneur who has furnished the risk bearing capital and not the preference shareholder. The Business Profits Tax has been the most important single factor affecting capital formation and the development of existing industries. Its abolition will cost Rs. 8 crores, of which Rs. 3·63 crores will come back by an increase in the yield from super-tax and income-tax, leaving a net loss of Rs. 4·37 crores.

63. The second proposal is a reduction in the income-tax paid by companies, with a concurrent adjustment in the rate of super-tax. It is proposed to reduce the rate of income-tax payable by companies from 5 annas to 4 annas but raise the company super-tax by half an anna. The reduction in income-tax is estimated to cost Rs. 10·56 crores but this will be set off to the extent of Rs. 5·28 crores by the increase in super-tax, the net loss remaining at Rs. 5·28 crores. This reduction will help companies to plough back more of their profits into their business and is designed to assist in the development of industries. Even with this reduction, the general rate applicable to a company, taking income-tax and super-tax together, will be 6½ annas, *i.e.*, half an anna more than the rate during 1946-47.

64. The third proposal is to reduce the tax payable on slabs of personal income between Rs. 10,000 and Rs. 15,000 by half an anna, from 3½ annas to 3 annas. The middle classes have been the most hit by the rise in prices in recent years and the process of giving them some relief began last year when the rates for incomes upto Rs. 10,000 were reduced. It is now proposed to carry the relief to the next logical step. This

concession may encourage these classes to save a little more and invest it in Government loans or in industry. The proposed tax reduction in a few typical cases will work out as follows:—

Total Income.	Pre-war rate.	Present rates		Proposed rates.	
		Earned Income.	Unearned Income.	Earned Income.	Unearned Income.
	Per cent.	Per cent.	Per cent.	Per cent.	Per cent.
12,000	6·75	5·6	9·6	5·6	9·0
13,200	6·75	6·3	10·7	6·2	9·9
14,400	6·75	7·2	11·6	6·9	10·6
15,000	6·75	7·7	12·0	7·5	11·0

The cost of this concession will be Rs. 1,01 lakhs.

65. It is also proposed, as a further measure designed to stimulate saving and investment, to reduce the tax on the slab of income in excess of Rs. 15,000 from 5 annas to 4 annas. The effect of this reduction, on a few typical cases, will be as follows:—

Total Income.	Pre-war rate.	Present rates		Proposed rates.	
		Earned income.	Unearned income.	Earned income.	Unearned income.
	Per cent.	Per cent.	Per cent.	Per cent.	Per cent.
18,000	9·0	9·3	15·2	8·5	13·3
19,200	9·0	10·0	16·3	9·0	14·1
20,000	9·0	10·6	16·8	9·5	14·5
24,000	10·7	14·0	19·2	12·1	16·2
25,000	10·7	14·7	19·7	13·1	17·3

This concession is estimated to cost Rs. 6·5 crores.

66. Certain changes are also proposed in the field of personal super-tax. The first important change is the abolition of the distinction between earned and unearned income, so far as super-tax is concerned. The distinction between earned and unearned income for super-tax purposes was introduced in 1946-47. So far as income-tax is concerned it takes the form of a reduction from taxable income of 20 per cent. of that income, subject to a maximum of Rs. 4,000. In other words, the need for earned income relief is, in effect, not recognised in respect of income exceeding Rs. 20,000. Super-tax is payable

only on income in excess of Rs. 25,000 and the present arrangement is open to the criticism that it is illogical to give a relief in super-tax on income above this limit while denying it in respect of income at a lower reach. Such a distinction is also not recognised in other countries, like the United Kingdom or the U.S.A., in the sur-tax field. Relief in respect of earned income is on a par with relief for family provision, such as payment of insurance premia or subscriptions to Provident Funds, and a concession in respect of this kind of provision is not allowed in these countries in respect of sur-tax. The relief now given in respect of super-tax, without extending it to company super-tax, has also produced an anomaly as it affects adversely the class of people who invest in public companies, as the dividen from such companies is not treated as earned income. In actual working also the existing distinction has created a good deal of administrative difficulty in assessing the tax of people who, in addition to personal income, have also income from dividends and interest on securities. The abolition of this distinction between earned and unearned income in the super-tax field is therefore both logical and consistent with the taxation practice of other modern countries. The second change is the reduction of the maximum rate of super-tax from 9 annas for earned income and 10 annas for unearned income to 8½ annas. The rates for the various slabs have also been recast. The revised rates, which will apply to all income without distinction between earned and unearned income, have been fixed at one anna more than the present rate for earned income except that the maximum is reached on incomes above Rs. 1½ lakhs. This apparent increase by one anna is more than offset by a decrease in the maximum rate of income-tax by one anna. The statement below compares the present and the proposed rates for the various slabs of income.

	Slab	Highest income in slab.	Present rates		Proposed Common rates
			Earned income	Unearned income.	
1.	25,000	25,000	*nil*	*nil*	*nil*
2.	15,000	40,000	2 As	3 As.	3 As.
3.	15,000	55,000	3 ,,	4½ ,,	4 ,,
4.	15,000	70,000	5 ,,	6 ,,	6 ,,
5.	15,000	85,000	6 ,,	7 ,,	7 ,,
6.	15,000	1,00,000	6½ ,,	8 ,,	7½ ,,
7.	50,000	1,50,000	7 ,,	9 ,,	8 ,,
8.	1,00,000	2,50,000	8 ,,	9½ ,,	8½ ,,
9.	1,00,000	3,50,000	8½ ,,	10 ,,	8½ ,,
10.	Balance over 3½ lakhs ...		9 ,,	10 ,,	8½ ,,

67. It is also proposed to give a concession in respect of the income of Hindu undivided families. Last year the exemption limit in respect of the income of such families was raised to Rs. 5,000. This limit will be raised by a further Rs. 1,000 to Rs. 6,000, making it double the amount of exemption allowed for individuals. The cost of this concession is estimated at Rs. 12 lakhs.

68. The net result of the above changes may now be summarised. The abolition of the Business Profits Tax involves a loss of Rs. 8 crores. The concession to undivided Hindu families will cost Rs. 12 lakhs, the reduction in the rate of income-tax on incomes from Rs. 10,000 to Rs. 15,000 will cost Rs. 1,01 lakhs, the reduction in the company rate of income-tax Rs. 10·56 crores, the reduction in the maximum rate of income-tax Rs. 6·5 crores, a total reduction in revenue of Rs. 26·19 crores. This loss will, however, be set off to the extent of Rs. 3·63 crores by increased company super-tax and income-tax resulting from the abolition of the Business Profits Tax, an increase of Rs. 2·29 crores in revenue due to the abolition of the distinction between earned and unearned income for super-tax purposes and the revision of the super-tax rates, and an increase of Rs. 5·28 crores in company super-tax following the increase of half an anna in the rate, leaving a net loss of Rs. 14·99 crores. Of this loss, a little less than half, namely, Rs. 7·12 crores will fall on the States while the balance of Rs. 7·87 crores will fall on the Centre.

69. One further concession in the field of income-tax may also be mentioned. In order to encourage house building and the expansion of business, a concession has been given that the income from houses built before the 31st March 1950 will be exempt from taxation for a period of two years. A similar concession in respect of initial depreciation allowance was also given for buildings constructed for business before the 31st March 1950. This concession is being continued in respect of buildings that may be constructed within the next two years also and necessary provision is being made in the Finance Bill for this purpose.

70. Provision is also being included in the Finance Bill for the more effective collection of income-tax on tramp steamers whose owners do not maintain an agent in India. The practice now is to make a provisional assessment by assuming that the income is only 5% of the freight earnings in India. Experience has shown that this is far too low, as none of them ever comes up for a final assessment on the basis of actual profits. It is therefore proposed to increase the percentage from 5% to

16⅔% subject, of course, to adjustment at the time of final assessment.

Indirect Taxes.

71. It is not proposed to make any change in the field of indirect taxation. But it must be remembered that only a few days ago a substantial decrease in taxation was effected in this field by the reduction in the excise duty on super-fine and fine cloth. The loss of revenue involved in a full year is estimated at Rs. 3½ crores, allowance for which has already been made in the revenue estimates.

Changes in Postal Rates.

72. On the Postal side it is proposed to give a concession in respect of local letters and local post-cards, *i.e.*, letters and post-cards delivered within the limits of the city or town in which they are posted. The rate for local letters will be 1 anna for the first tola instead of 2 annas as at present, the existing rate of one anna for every subsequent tola remaining unchanged. The rate for local post-cards will be six pies. In several advanced countries such a distinction between local and extra-local deliveries is a feature of the postal system and this may also result eventually in an increase in the volume of business. This concession is expected to cost Rs. 20 lakhs.

73. In regard to charges on telegrams a reduction of one anna in the basic minimum charge will be made for ordinary telegrams and two annas for express telegrams. This measure is intended to mitigate to some extent the effect of the increases in telegraph rates which were made during the last war and have continued since then. The loss of revenue is estimated at Rs. 10 lakhs.

74. It is also proposed to reduce the maximum trunk call rate for a three-minute call from Rs. 16 to 12 for an ordinary call and from Rs. 32 to Rs. 24 for urgent calls and to extend slightly the periods during which trunk calls can be made at concessional rates. This concession which will assist the public and the business community and, eventually, develop the wider use of the long distance telephone is estimated to cost Rs. 14 lakhs.

75. As mentioned earlier, the net loss from the reductions of taxation in income-tax will cost the Central Exchequer Rs. 7·87 crores. The Postal concessions will, in the aggregate,

cost Rs. 44 lakhs, raising the total loss of revenue to Rs. 8·31 crores. This will reduce the surplus from Rs. 9·62 crores to Rs. 1·31 crores.

Final Position.

76. The final position may be summarised as follows:—

	(In crores of Rs.)
Revenue	339·19
Expenditure ...	337·88
Surplus	+1·31

A detailed Summary appears at the end of this Paper.

77. Taking the budget as a whole, during the two years ending with the budget year, the Central Government would have drawn on its balances to the extent of Rs. 114 crores for meeting its expenditure. This, however, does not mean inflationary spending as in this period the provision for net remittances for financing Governmental expenditure abroad amounts to Rs. 345 crores representing largely the cost of the purchase of food, stores, etc., and a small amount of expenditure on the payment of pensions, leave salaries and so on. In these two years, taking all Governmental transactions together, the net rupee surplus will, on these estimates, amount to Rs. 231 crores and the entire reduction in the accumulated balances would have been utilised for financing expenditure outside the country.

SUMMARY OF FINAL ESTIMATES

Revenue.

(In lakhs of Rs.)

	Revised 1949-50	Budget 1950-51
Customs	120,43	106,54
Union Excise Duties	69,19	71,55
Corporation Tax	40,60	38,72 -62*
Taxes on Income other than Corporation Tax ...	108,40	143,90 -14,37*
Opium	1,28	1,55
Interest	1,32	1,14
Civil Administration	7,17	7,87
Currency and Mint	9,99	9,52
Civil Works	1,13	1,27
Other Sources of Revenue	7,82	9,79
Posts & Telegraphs –Net Contribution	3,77	4,48 —44*
Railways—Net Contribution	7,00	6,37
Deduct—Share of Income-tax revenue payable to States	-45,74	-55,20 + 7,12*
TOTAL REVENUE ...	332,36	339,19

Expenditure.

Direct demands on revenue	13,69	13,81
Irrigation	11	23
Debt Services	38,81	36,50
Civil Administration	40,89	50,06
Currency and Mint	2,43	1,76
Civil works	8,13	9,97
Pensions	2,68	7,45
Miscellaneous—		
Expenditure on displaced persons	13,70	6,00
Subsidy on foodgrains	29,67	21,00
Other expenditure	4,67	4,24
Grants to States, etc.	2,96	15,41
Extraordinary items	1,70	1,44
Defence Services (net)	170,06	168,01
Pre-partition Payments	6,60	2,00
TOTAL EXPENDITURE ...	336,10	337,88
Deficit ...	—3,74	Surplus +1,31

*Budget Proposals.